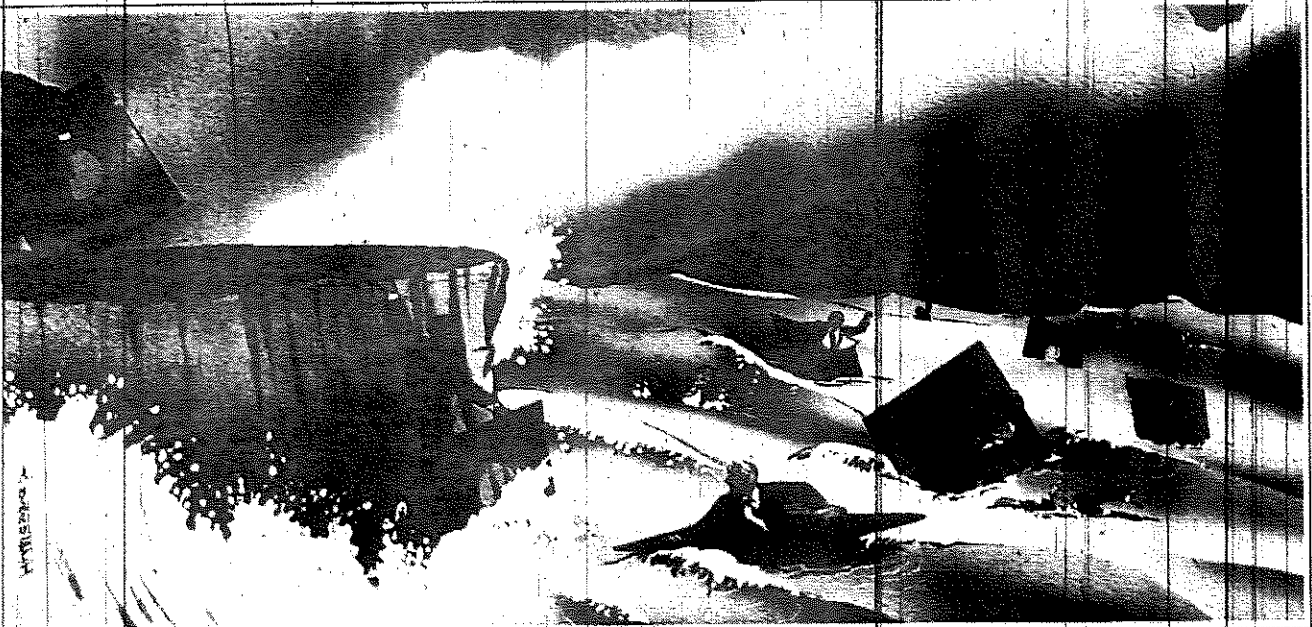


Information Processing

SOFTWARE

THE SHAKEOUT IN SOFTWARE: IT'S ALREADY HERE



No one expected the halycon days of the personal computer software business to pass so quickly. Industry experts had projected that this market would continue to double annually, and 3,000 hopefuls, as a result, had jumped into the fray. But the glut of suppliers, along with the soaring cost of marketing new products and a flood of me-too programs, is changing the picture dramatically. As John D. Couch, former head of software development at Apple Computer Inc. and now chief executive of a software startup called Light Year Inc., puts it: "The industry's got one foot on a banana peel and the other in Chapter 11."

Rapidly appearing are the telltale signs of an industry shakeout—bankruptcies, buyouts, layoffs, and price-cutting. To make matters worse, the market has failed to live up to earlier predictions. "The market is still growing, but there are so many companies now that it's not sustainable for everyone," says Egil Juliussen, chairman of Future Computing Inc., a McGraw-Hill subsidiary that tracks the personal computer industry. The initially giddy estimates have been revised downward: Sales this year should still grow impressively—topping \$2.3 billion, up from

\$1.45 billion in 1983. But this will amount to an increase of only 60%, a far cry from the original 100% forecast.

In recent months, Sirius Software Inc., Software Guild, and its parent, Softsmiths Corp., have filed for Chapter 11 protection. Publisher Readers Digest Associates Inc. and ASK Computer Systems Inc., a minicomputer software vendor, both pulled out of the personal computer software business. Management Science America Inc. and On-Line Software International Inc. have just reported quarterly losses. Sorcim Corp. and Information Unlimited Software Inc. were acquired by Computer Associates International Inc.

Numerous other personal computer software companies, including early market leaders VisiCorp and MicroPro International Corp. have laid off more than half their staffs. One software distributor, SKU Corp., purchased in February by McKesson Corp. and Action Industries Inc., has not performed well and is up for sale.

A NEW MIX. The tightening competition has changed the rules dramatically. Gone are the days when software-hungry computer enthusiasts were buying every major new program that came on the market. Now a staggering 20,000

programs are available for the 5 million or so personal computers in use. Hundreds of me-too products are fighting it out in major categories such as word processing, and consumers are buying only one version—whether it is word processing software, a data base, or a spreadsheet program. Forced into fierce marketing fights to differentiate their products, software vendors must spend more on advertising to get customer attention and win retail shelf space.

Once the dust settles from the current turmoil, the industry should end up with a different mix of companies. The larger personal software companies—Software Publishing, Lotus, and Microsoft, to name three—should continue to thrive along with the established, mainframe software vendors, such as Cullinet, Management Science America, and International Business Machines. Software Publishing Corp. racked up record sales in June and July of its PPS line of software, despite the industrywide slowdown. And sales at Lotus Development Corp. continue to double year-ago results.

The hordes of startups and small companies, however, may not have the resources to go it alone in the fast-maturing market. Already, many are beginning to work closely with the large-

er software companies. Ashton-Tate Inc. bought its new Framework integrated software from Forefront Corp., a small Mountain View (Calif.) software developer. Others are entering into developer-publisher agreements with established publishers. "The days of the one-man band are over," says David J. Evans IV, director for talent of Electronic Arts, a software publisher that mixes in-house programming with publishing products from more than 80 independent developers. Even software agents have cropped up. Operating like literary agents, they match independent software authors with publishers (BW—Aug. 6).

For both new and established software companies, however, the bottom line for success will be innovative product design. At last count, there were 200 or more word processors, 150 spreadsheets, 200 data base programs, and 95 integrated packages that offer at least three functions. Moreover, distributors report that of the 20,000 programs on the market, a mere 20 make up as much as half of their total business. A program now "has to be significantly better to even have a chance," says Robert S. Leff, president of Softsel Computer Products Inc., a large software distributor that carries 2,300 titles and sells to more than 4,000 outlets nationwide.

'ABYSMAL FAILURE.' Some examples of new ideas are already beginning to show up. Menlo Corp., a startup, has introduced InSearch, a program that allows personal computer users to locate information more easily in the widely used, but arcane, Dialog Information Service Inc. data base. Another new package, called ThinkTank, introduced last year by Living Videotext Inc., allows a user to make an outline for a document, then store and manipulate information under the headings. The document can be expanded to display the text under each heading or collapsed to show only the main outline (box). Already two companies, Ashton-Tate and Select Information Systems Inc., have copied the concept.

Even when an innovative program is published, the developer has a major, expensive hurdle to get over to establish a market identity. Ashton-Tate, for one, has already launched a \$10 million advertising campaign to back its new Framework package. But that large an expenditure can be wasted, too, observers say. "That's more like getting above the noise level than prudent spending," comments Light Year's Couch.

One pint-size company, Select Information Systems Inc., initially decided that it could advertise its way to success but had to change its tune. The Kentfield (Calif.) company grew steadily for two years selling word processing software directly to hardware manufacturers such as Digital Equipment, Xerox,

and NEC. But last November, Chairman Martin L. Dean decided to expand into the retail market and went public to raise what he thought would be enough cash. Now, less than a year later, he admits that "our retail entry was a total and abysmal failure." The company raised \$2.5 million and proceeded to spend \$1.1 million on advertising and marketing, only to sell \$200,000 worth of software. "The [marketing budget] was a lot of money for us, but not enough for this market," says Dean.

By March, Dean had halved his work force to 29 employees and was rethinking company strategy. "We decided to concentrate on what we do best—product development," he says. Select tripled its R&D efforts and found a partner—Intelligent Systems Corp., which sells to 2,000 outlets—to market its software.

Such back-to-basics strategy has been used before, after successful players overstepped their own expertise. One classic example is VisiCorp. After the outstanding success of the VisiCalc

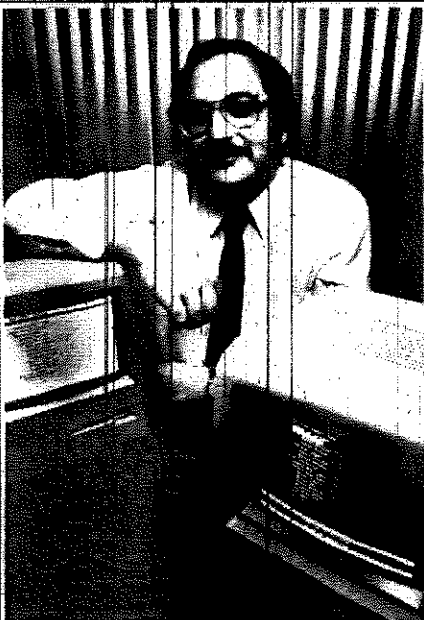
THINKTANK: A PROGRAM THAT MOVES BEYOND WORD PROCESSING

Four years ago, David M. Winer got the chance to design a word processing program for VisiCorp, the publisher of the highly successful VisiCalc spreadsheet. He had all but finished a personal computer program that he called an "ideas processor," and VisiCorp management believed it could be easily turned into a word processor. But the personal computer software market already was jammed with me-too word processors, and Winer had a hunch that his ideas processor could become a new class of software. "There was a gap in the market for a product that let people manipulate and organize words, not numbers," he recalls.

Winer decided to go it alone, without VisiCorp, and started Living Videotext Inc. in June, 1981. Now, ThinkTank is beginning to climb the software best-seller charts. By contrast, VisiCorp's own word processing software has been a slow seller, beaten out by several other brand-name word processors.

His concept of an ideas processor represents the kind of innovative program that personal computer software companies must develop to survive in the increasingly cutthroat market. ThinkTank allows users to make an outline of a document, with headings and subheadings, then manipulate information under each heading. The outline can be collapsed to display only headings or expanded to show the information stored in each section. Already, two software companies have built these so-called outliners into their products.

ROLL OF THE DICE. The road to recognition for ThinkTank, however, was not easy. Winer initially found it tough to explain to retailers why people would want to use it. To make matters worse, Living Videotext was short on cash, and the venture capital community was leery of such a different product. "As



WINER GOT LIVING VIDEOTEXT ON ITS FEET WITH AN "IDEAS PROCESSOR" FOR APPLE

late as the end of 1983, venture capitalists only wanted to invest in [companies selling] the five major applications," says Winer, referring to word processing, data base, spreadsheet, graphics, and communications software. Living Videotext has since been able to raise money through private investors.

Not shy of taking chances, Winer decided last September to devote a considerable share of his limited resources to writing software for Apple Computer Inc.'s then-unannounced Macintosh computer. And his Mountain View (Calif.) company has profited by that decision. When Macintosh sales took off this year, ThinkTank was one of a handful of software packages available for it. "Mac looked like a good roll of the dice," says a smiling Winer. "And we just turned profitable."

ED MASH

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spreadsheet, which was developed by Software Arts Inc. and marketed by VisiCorp, the company decided that it, too, could be a software developer. But VisiCorp spent more money and time than expected on its Visi On software. The product was late to market, and by the time it arrived, competitors were hot on its heels with their own software.

After less than a year of disappointing sales, VisiCorp was forced to lay off more than half of its 200 employees. And in late July, the company decided to get out of Visi On product development and go back to selling it. It sold the entire Visi On R&D operation to Control Data Corp. "Visi On was a gamble... and we weren't able to see it through," admits Michèle T. Niven, a VisiCorp product manager. "But we are still terrific publishers."

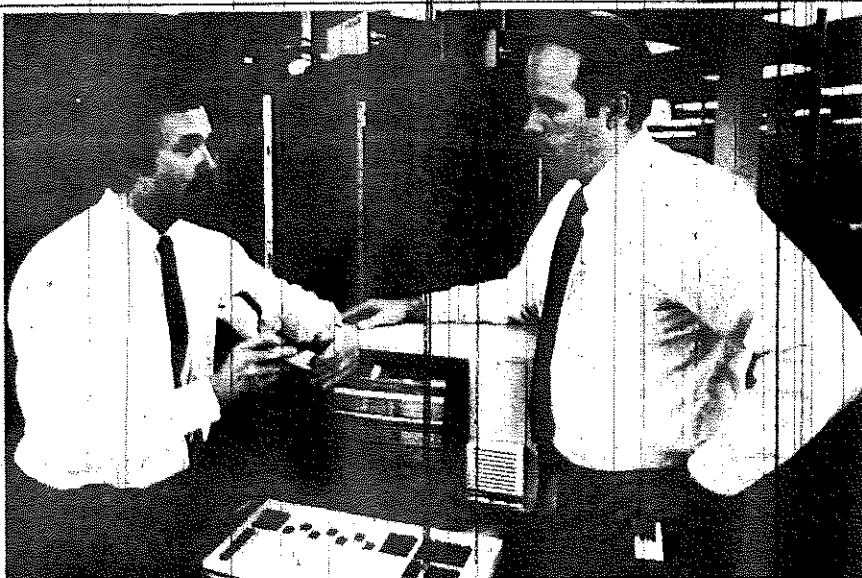
TAKING CHANCES. The devastating competition that pushed VisiCorp out of software development is also taking its toll on distributors and computer specialty stores. Over the past year, the average price of business programs for personal computers has plummeted from \$500 to about \$300 per package. But it costs the retailer as much to sell the \$300 package as it did when it sold for \$500. To pick up the slack, many software specialty stores and distributors, including Micro-D Inc. and Softsel, have added printers and other personal computer peripherals to their product lines. One software-only chain, Software Centre International, which operates 60 software store franchises nationally, recently was forced to close 5 of its 11 company-owned stores because it expanded too rapidly in a slowing market.

Amid all this gloom, however, are some bright spots. Developments in the hardware market, such as new personal computers from AT&T Information Systems Inc. and the Macintosh from Apple Computer Inc., continue to open up opportunities for software developers. In addition, IBM, which has been marketing its IBM PC for two years, is expected to introduce a new model in August.

For these reasons, some retailers and venture capitalists are willing to take chances on a software startup. "We are still looking at making commitments, although the traditional wisdom is that the bloom is off the rose," says L. John Doerr III, a partner at Kleiner Perkins Caufield & Byers. The California venture firm recently closed a deal with Haba Systems Inc., a developer of programs for Apple's Macintosh. Adds Paul M. Schuman at BusinessLand Inc., a national computer retail chain: "It's a balancing act, but we would take a chance on a unique product from a new company without a track record."

COMMUNICATIONS

MITEL STRIVES TO GET BACK ON THE FAST-GROWTH TRACK



PRESIDENT MATTHEWS BROUGHT IN GILMORE TO TIGHTEN UP COMPANY OPERATIONS

After Donald R. Gibbs, chief operating officer at Mitel Corp., resigned in June, the company was quick to hire George H. Gilmore, a consultant with McKinsey & Co. His specialty: corporate turnarounds. Bringing Gilmore on board was not the only sign of urgent new priorities at Mitel, a telecommunications equipment maker once regarded as one of Canada's premier high-tech success stories but lately fallen on hard times. Just a few months earlier, the company had recruited Martin F. McDermott to join its U.S. operations as vice-president for sales and marketing. His area of expertise: rescuing financially troubled telecommunications companies.

Mitel used to disdain professional managers and their textbooks. Now the Kanata (Ont.) company cannot get enough of them. In the past two years, marketing blunders, product delays, and management turmoil have come together to plague Mitel, bringing losses and tarnishing its image on Wall Street.

"There's no way I'd have any of our clients in that stock right now. There are good bets and poor ones, and this is one of the poor ones," asserts Murray Grossner, an analyst at Toronto's Richardson Greenshields of Canada Ltd.

As recently as early 1983, the then \$200 million company predicted it would

be garnering annual revenues of \$750 million by 1986. And last year it held a 12% share of the U.S. market for private branch exchange (PBX) telephone switchboards, mostly due to growing shipments of small PBXs with a capacity of less than 150 phone extensions. But something has gone wrong. "Mitel seems to have effectively run out of a game plan," says John F. Malose, president of Eastern Management Group, a Parsippany (N.J.) industry consultant.

Increasingly, analysts believe that Mitel is on the verge of a dramatic change in equity structure. It needs deep pockets to explore the fast-unfolding office automation market, and it is one of the few companies in its league that has not acquired a partner. Last year, International Business Machines Corp. dalled briefly with Mitel before buying an equity stake in rival Rolm Corp., a move that was widely viewed as a thumbs-down for Mitel. The Canadian company may now be ready for another pass. But to attract a significant merger or joint-venture partner, the company will have to adapt its style of doing business to the demands of big-company bureaucracy.

For its part, Mitel has blamed most of its problems on the market's fickleness as it struggled to solve technical glitches in an ambitious new PBX it was developing. Indeed, Terence H. Matthews, Mitel